

January 27, 2011

U.S. Department of Labor
Employee Benefits Security Administration

Re: Comments on DOL Proposal to Expand the Definition of Fiduciary

I am the owner and sole professional of a small business valuation firm that consists of myself and two part-time assistants. I am a long-time Accredited Senior Appraiser of the American Society of Appraisers. I have over 30 years of experience in providing business valuations, many of which are for ESOPs. I am a former member of the Valuation Advisory Committee of The ESOP Association. I provide high-quality appraisals and charge reasonable fees. My clients frequently praise the thoroughness of the appraisal analysis.

I have the following six primary concerns with the DOL proposal:

- 1) It will force experienced ESOP appraisers to exit the market.
- 2) An appraiser that is a fiduciary can no longer be considered “independent.”
- 3) Distinctions must be made as to the broad array of services provided by ESOP valuers.
- 4) Better remedies are available to address the “problem.”
- 5) The only beneficiary of the proposal will be ESOP litigation attorneys.
- 6) The problems raised by co-fiduciary liability.

These concerns are detailed below.

1. If your proposal is enacted, I may be forced to exit the ESOP valuation arena. It is doubtful whether a sole practitioner like myself will be able to obtain fiduciary insurance. The personal financial risks would be too high to continue to provide ESOP appraisals without liability coverage. While the plight of one appraiser is not the DOL’s concern, consider that all of my ESOP clients will be forced to find another service provider that will probably 1) be less qualified than myself, 2) provide appraisals that are less comprehensive and of a poorer quality and 3) charge a significantly higher fee.

Because of the inability to obtain fiduciary insurance, small firms with experienced ESOP valuers may be replaced by a limited number of national accounting/appraisal firms, with much of the work done by inexperienced junior analysts. To enact regulations that would likely force some of the best professionals to exit the ESOP appraisal market would be a detriment to ESOPs and Plan participants. Your proposal would harm the very people you are seeking to safeguard. For those appraisers that are able to secure fiduciary liability insurance coverage, the fees charged for ESOP-related valuation services would rise substantially.

2. A critical flaw of the DOL proposal is that it conflicts with current law. Current law requires that an ESOP purchase Plan assets at no more than “adequate consideration” and sell Plan assets at no less than “adequate consideration,” with adequate consideration defined as fair market value. For stock in a private company, fair market value must be determined by an independent qualified appraiser, although the DOL has yet to issue definitive guidelines as to what constitutes “independent” or “qualified.”

According to Webster’s dictionary, a “fiduciary” is “a person to whom property or power is entrusted for the benefit of another.” In ESOP terms, a fiduciary’s role is to act in a manner that is solely in the interests of Plan participants. An ESOP is one party to a two-party transaction to buy or sell stock in the sponsor company. If the appraiser hired by the ESOP is considered a fiduciary, it is impossible for them to be “independent.”

I believe the American Society of Appraisers (“ASA”) is the most respected business valuation trade organization. Members of ASA must prepare appraisals in accordance with the *Uniform Standards of Professional Appraisal Practice* (“USPAP”). My personal opinion is that all appraisals for ERISA (i.e., ESOPs) and the IRS (i.e., gift, estate and income tax work) should be done in conformance with USPAP. All appraisals done by a member of ASA must also adhere to ASA’s Standards of Practice and Code of Ethics. USPAP and ASA’s Standards of Practice and Code of Ethics require that the appraiser be “independent” and have “no bias with respect to the parties involved.” If an appraiser is considered an ESOP fiduciary, he/she does not meet either of these tests. As a fiduciary, he/she is not independent and has a bias with regard to one of the parties involved. Based on a strict adherence to USPAP and the Code of Ethics, essentially no credentialed appraiser would be allowed to prepare ESOP appraisals.

3. I believe a distinction should be made between ESOP professionals that are providing “appraisals” (i.e., an independent opinion of fair market value) and more complex “financial advisory” services. The ESOP community often uses these terms interchangeably. They are different.

An “appraisal” provides an unbiased opinion of the fair market value of an asset by someone who is qualified by training, experience, etc., to provide such an opinion. An appraisal provided to an ESOP trustee must arrive at the same conclusion as an appraisal that was prepared for a selling shareholder in the sponsor company. It has to. If it does not, the appraiser has violated the “independence” and “bias” provisions of *USPAP* and the Code of Ethics. It makes no sense to consider an “appraiser” that is providing this service to be a fiduciary.

A valuation professional providing “financial advisory” services to an ESOP is a different matter. Valuation firms that provide “financial advisory” services in connection with an ESOP transaction often do not provide an “appraisal.” They may provide only a fairness opinion. The purpose of a fairness opinion is to provide assurance that a transaction is fair to a specific party “from a financial point of view.” Unlike an appraisal, where the work product is to provide an independent opinion of value, the role of a financial advisor to an ESOP in a transaction is to ensure that the transaction is fair “from a financial point of view” to the ESOP. The financial advisor is not independent.

The role of a financial advisor in a transaction is much broader than simply providing an opinion of value. The financial advisor may actively participate in negotiations, may help structure the transaction, may assist in arranging financing, may assist in finding a potential buyer, etc. In these circumstances, the financial advisor is acting as an agent of the ESOP (not as an independent appraiser) and it is understood that their role is to help “negotiate the best deal possible for the ESOP.”

Many “appraisers” (including myself) do not provide the complex financial advisory services described above. Our role is to provide the ESOP trustee with an independent appraisal of fair market value. The investment decision is strictly that of the trustee, who must consider a myriad of factors in addition to “fair market value.” Appraisers are not in the business of providing investment advice in that we do not provide a recommendation to buy or sell securities. We have no authority (or responsibility) to manage Plan assets. The role of an independent appraiser is not to assist the trustee in negotiating the “best deal.” It is simply to provide the trustee with an objective, unbiased analysis so that the trustee does

not violate the “adequate consideration” requirement. The DOL must make a distinction as to the type of service provided to the ESOP. It is not appropriate to lump all types of valuation services together.

4. The DOL’s definition of fiduciary with regard to ESOPs has been in effect since 1976. The logic that was espoused in DOL Advisory Opinion 76-65 is still just as valid today as it was in 1976. Remedies are already available to trustees to bring actions against appraisers for “faulty appraisals.” Less drastic alternatives are available to the DOL. These include issuing final ESOP valuation regulations and requiring that ESOP appraisers be credentialed by a professional appraisal organization (such as ASA) that has a Code of Ethics and/or conforms to *USPAP*. The problem might be best addressed by ensuring that existing fiduciaries (such as ESOP trustees) have some minimum financial background (or degree of knowledge of business valuation) so that they can competently assess the valuation work provided to them.

5. The only beneficiary of your proposal would be ESOP litigation attorneys who are trolling for ESOP companies that have fallen on hard times. Irregardless of the fact that this country has still not emerged from the worst economic downturn since the Great Depression, ESOP attorneys will undoubtedly blame “faulty appraisals” for a company’s financial difficulties and sue everyone in sight. If appraisers are now considered “fiduciaries,” it makes for a larger group of prime defendants.

6. A related issue is that of co-fiduciary liability. This will create a Pandora’s box when trying to assess how the responsibility for errors is allocated. With co-fiduciary liability, are different professionals (appraisers, attorneys, outside trustees, etc.) now responsible for each other’s work? As an appraiser, I am not trained in the law or in being a trust officer, nor do I want to be.

In conclusion, I believe the current DOL proposal will do more harm than good for the entire ESOP community and Plan participants.

Thank you for your consideration.

Sincerely,

Mark P. Pagano, CFA, ASA
Sole Member
Pagano Appraisal Group, LLC